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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1990

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JAMES B. MARINE AND VERA L. MARINE

Petitioners

vs.

COMMISSIONER OF INTERNAL REVENUE

Respondent

==========

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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QUESTIONS PRESENTED FOR REVIEW

The questions presented for review are:

1. Should taxpayers who invested cash in limited partnerships that bought Post Office real estate leased to the U.S. Government, be denied deduction in investment years for loss of their cash which a fraudulent general partner embezzled in those years, claiming that he spent it for interest on a non-existent partnership debt?

2. Should they be denied ongoing deductions for partnership losses caused by building depreciation and interest based on mortgage debt created by the general partner's concealed fraudulent operation of buying the Post Offices and reselling them to his partnerships at a large price mark up for his own personal profit?

3. Should they be subjected to penalties, essentially the result of tainting them with the fraud upon them, where they were ignorant of that fraud until preparation for and trial of this case, but where IRS had discovered that fraud several years earlier?

LIST OF ALL PARTIES TO THE PROCEEDING

All parties to the proceeding are named in the above caption of this case.

However, there are a number of taxpayers with cases pending in Tax Court (herein "co-litigants") who have stipulated to be bound by the outcome of this case as to "Schulman partnership issues", i.e., the issues presented by this case; those who have been represented by undersigned counsel are listed in Appendix C hereto.

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REPORTS OF DECISIONS AND OPINIONS HERETOFORE RENDERED IN THIS CASE

This is a Petition for Writ of Certiorari to the Circuit Court of Appeals for the Ninth Circuit seeking this Court's review of its Memorandum decision filed January 2, 1991 in Case No. 89-70451, which affirmed the Tax Court decision in Docket No. 8077-85 entered August 4, 1989 on the Tax Court Opinion reported at 92 TC 958.

Said Memorandum decision and Tax Court Opinion are reproduced in Appendix A hereto, along with Ninth Circuit Order denying a petition for rehearing.

GROUNDS ON WHICH JURISDICTION OF THIS COURT IS INVOKED

(i) The Memorandum decision sought to be reviewed was filed January 2, 1991.

(ii) A petition for rehearing of that decision was timely filed with the Ninth Circuit Court of Appeals by mailing on

January 16, 1991. Said petition for rehearing was denied by Order of the Ninth Circuit Court of Appeals filed February 21, 1991. Accordingly, the time within which this Petition may be filed expires 90 days thereafter, or on May 22, 1991. 28 U.S.C. § 2101; Supreme Court Rule 13.1, 13.4.

(iii) Petitioners duly filed their petition for Tax Court review of the IRS notice of deficiency, pursuant to IRC Section 6213. Appeal from the Tax Court decision to the Ninth Circuit Court of Appeals was duly taken pursuant to IRC Sections 7482 and 7483.

(iv) The statutory provision conferring on this Court jurisdiction to review the decision of the Ninth Circuit Court of Appeals by Writ of Certiorari is 28 U.S.C. Section 1254.

STATUTES, REGULATIONS AND COMMITTEE REPORTS INVOLVED IN THIS CASE

The statutes, regulations and Committee Reports involved in this case are reproduced in Appendix B hereto, Part 1 and Part 2.

REFERENCES

For ease of discussion we will use the following references herein:

IRS	=	Commissioner of Internal Revenue, Respondent herein.
co-litigants	=	Tax Court petitioners who have stipulated to be bound by this case as to Schulman issues.
investors	=	taxpayers who invested cash to become limited partners in partnerships formed and managed by Gerald L. Schulman.
Marines	=	James and Vera Marine, petitioners herein.
X-(followed by a number)	=	reference to the Excerpts of Record prepared for the Ninth Circuit Court of Appeals, containing copies of key documents and excerpts of testimony.
Ex.	=	stipulated exhibits, of which there are 122.

Tr.	=	reference to transcript of testimony

STATEMENT OF THE CASE

Following is a summary Statement of this Case. For ease of reading, record references are omitted here, but included in the more detailed discussion under Argument, below.

James and Vera Marine, taxpayers here, were good faith investors in two Schulman partnerships that acquired Post Office real estate leased to the US Government. Gerald L. Schulman, the promoter-sole-general-partner of some 600 such partnerships, pretended to spend his investors' cash contributions to pay deductible interest on short term partnership borrowings useful in arranging the long term mortgages each of which represented the purchase price paid by a partnership.

In its own confidential investigation of Schulman, IRS discovered that he was operating a giant fraud: for his own

personal profit, he bought Post Offices and other public buildings and resold them to his partnerships at a large mark-up. Using off-shore money movements, he simulated the short-term borrowings which were in fact shams; no interest was paid thereon. The conclusion that Schulman had embezzled the funds for his personal use, and that his fraud was essentially upon his investors, was inescapable.

Schulman appointed and paid his personal tax counsel to represent his investors in Tax Court. IRS made an offer that investors could preserve later year depreciation and interest deductions and avoid penalties by giving up deduction for initial loss of their cash. Said counsel, acting in acknowledged conflict of interest, ultimately recommended that their investor-clients accept that offer, which several thousand did.

The Marines and a handful of co-litigants did not. IRS has thus far successfully contended that these non-settling investors were participants in an abusive tax shelter, entitled to no deductions whatsoever, and liable for penalties. This, though no one told them of Schulman's fraud upon them: not IRS, not Schulman, and not their in-conflict counsel. The fraud upon them was finally revealed to them from IRS files and witnesses in the course of preparation for and trial of this case.

ARGUMENT

1. Why this case is so important as to merit this Court's time and attention. The Ninth Circuit Court of Appeals' decision below, and the Tax Court decision and Opinion which it summarily affirms, are in conflict with: a decision of this Court; another decision of the Ninth Circuit; and a decision of the Third

Circuit Court of Appeals; as will be explained below. Supreme Court Rule 10.1(a) and 10.1(c). But the most important reason for review by this Court is that the decisions below have sanctioned an IRS abuse of power, and in so doing, have "so far departed from the accepted and usual course of judicial proceedings **** as to call for an exercise of this Court's power of supervision." Supreme Court Rule 10.1(a).

In speaking of "abuse of power" by IRS, we mean: first, that it has enormous power, financial and in personnel; and second, that it has used its power to pursue an unjust result violative of the statutes and intent of Congress.

In Section 12(a) of this Petition, below, we describe the statutory provisions which clearly authorize theft loss deduction in the year of discovery of the loss; which in this case was the original

year of investment when the defrauder embezzled investors' cash but told them to deduct the loss as caused by payment of partnership interest.

In Section 12(b), below, we describe the statutory provisions which clearly authorize deduction of partnership loss resulting from interest and depreciation based upon non-recourse real estate mortgage debt.

2. The evidentiary record is undisputed. The evidence here consists of a lengthy stipulation with many exhibits; plus testimony which, apart from valuation testimony, is undisputed. Most of the facts are recited in the Tax Court's findings.[1] We will often cite pages of

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[1] At Op. p. 25 the Tax Court states that its decision in "this case is unaffected by the burden of going forward or the burden of proof because the stipulated facts establish the nature of the transactions at issue".

the Tax Court's Opinion to support our statements.

3. The Tax Court Opinion bespeaks its own error. We submit that a reading of the Tax Court's Opinion compels the conclusion that it was written to rationalize, point by point, a pre-determination to uphold IRS.

4. Inadequate review by the Ninth Circuit. The final brief to the Ninth Circuit was filed prior to the due date of April 30, 1990. Oral argument was had on December 6, 1990. The Ninth Circuit rendered its two sentence Memorandum Decision, affirming the Tax Court, on January 2, 1991. Such a Memorandum Decision is not to be published or cited as precedent. We submit that the Ninth Circuit was reluctant to get involved; did not adequately perform its review function.

5. Safe long term real estate investments offered by Schulman partnerships. Gerald L. Schulman, as promoter-sole-general-partner, formed some 600 limited partnerships each of which acquired a leased public building; most were Post Office real properties under long term lease to the U S Government. In 1979 James and Vera Marine, petitioners here, invested $60,000 cash in one of these, Clark Ltd., which acquired a leased Post Office in Jeffersonville Ind.; in 1980 they invested $36,000 cash in Trout Ltd., which acquired a leased Post Office in Sedalia, Mo.[2]

The Marines relied on Schulman's Offering Memos, were strongly attracted to these real estate investments which promised the safety of government rentals that would carry the properties and their acquisition mortgages; they thought of

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[2] Tax Court Op.pp.3-6.

these as investments for their retirement years.[3]

At Op.pp.3-5 the Tax Court describes Schulman's plan, set forth in his Offering Memos, for each partnership to borrow a large sum short term and use the proceeds temporarily to help arrange the long term purchase mortgage financing. Investors cash contributions to the partnership were to be used to pay the short term interest and therefore to be deductible. The Tax Court does not inquire whether or to what extent such a promised deduction was proper under then tax law; instead deems

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[3] Tax Court Op. pp. 3-5. See testimony of the Marines, Tr.pp.146-147, 156, X-33, including reference to approving comments from the President of Crocker Bank, who was brother-in-law to Jim Marine's business partner. Other Schulman investors testified similarly. Tr. pp.84 (X-29), 99-101 (X-30),115-119 (X-31), 132-135 (X-32). Leveraged real estate investments were very popular in 1979-'80; inflation was running at from 11.5% to 16.5% a year, see U S Dept. of Labor, Bureau of Labor Statistics, C P I 1967 = 100, 1979 and '80, all urban consumers, Los Angeles area.

that this tax benefit tainted investment purpose.

Schulman promised to pay for partnership tax returns, and investors' tax audits and legal representation, at no cost to the partnership.[4] He was thereby able to control his investors' tax cases for his own protection.

6. In 1983 Schulman negotiated an agreement with IRS to settle both his own tax liability and that of his investors. It provided that investors would be assured of all Schulman partnership loss deductions, except for disallowance (capitalization) of 30% of the first year cash loss deduction. Investors were not advised of this agreement at that time. The IRS approach to the 1983 agreement: was not that a Schulman partnership was a tax scheme rather than a legitimate realty investment; was for a moderate audit

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[4] Tax Court Op. p.4.

adjustment that permitted initial deduction of 70%, rather than 100%, of the first year interest payment.

In U.S.v.Schulman 817 F.2d 1355 (1987) the Ninth Circuit reinstated the tax fraud indictment of Schulman. In fn. 1, p. 1357, the Ninth Circuit refers to IRS withdrawal from the 1983 agreement after discovering Schulman's fraud in pretending, but not making, short-term interest payments. Notwithstanding that that agreement is a public record in the criminal proceeding entitled to judicial notice, and that Schulman purported therein to settle his investors' taxes, IRS opposed its introduction into evidence in this case and was sustained by the Tax Court (a manifest error).

7. IRS discovers the great Schulman fraud. Beginning in 1984 IRS discovered Schulman's giant fraud, but did not share

its discovery with Schulman's investors.[5] IRS records of the fraud were finally stipulated into the records of this case after various petitioner motions calling upon IRS for admissions.

The final story of Schulman's fraud on his investors is largely told at Tax Court Op. pp. 6-18 (he was convicted of tax fraud on February 12, 1988, Op. p. 19). With the aid of his brother-in-law Philip November and use of Panama corporations, Schulman himself was buying the Post

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[5] The Offering Memos for Clark Ltd. and Trout Ltd. speak of post offices purchased with favorable mortgage financing but say nothing about Schulman's role as seller, which his fiduciary position required him to disclose. The undisputed testimony of Ashworth (Tr. p. 90, X-29), Williams (Tr. p. 104, X-30), Newsom (Tr. pp. 124-125, X-31), Fruchbom (Tr. p. 139, X-32), and Marine (Tr. pp. 150-151, X-33) is that: until preparation for the trial of this case, they did not know that Schulman had taken their cash, or that he was the seller to their partnerships, of the post offices which he had just bought at a much lower price. Said four witnesses, other than Marine, are co-litigants.

Offices for cash and mortgages, reselling them to his partnerships for long term mortgage debt at a 75% to 100% price mark-up. The pretended short term partnership borrowings were shams---no interest was paid thereon. Schulman derived large sums of cash by pledging the long term mortgages to public lenders; his personal trusts received $77.7 million in cash advances from Drexel Burnham Lambert.

As the partnership tax returns show[6], Schulman took out of each partnership, in its initial year, all of the cash contributed to it by its investors. He did not spend that cash for interest, as he pretended. There was no place for it to go except into his pocket.

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[6] The partnership tax returns: for Clark Ltd., for 1979-1986, are Exs. 5-E through 8-H, 115 through 118; for Trout Ltd., for 1980-1986, are Exs. 9-I thru 11-K, 119 thru 122. See X-11, X-12, X-13, X-26, X-27.

The "Felcyn Account", between Schulman and his co-conspirator Margolis, verifies that destination, shows that all cash contributions to Schulman partnerships in 1977-1979 were expropriated by Schulman, used to pay his expenses and make down-payments on his purchases of properties; the cash profit (of several million dollars a year) and long term mortgages were allocated between Schulman and Margolis in agreed fashion.[7] The Tax Court (Op. p. 17) mentions the Felcyn Account, but ignores its significance.

In questioning his own witness, Schulman's brother-in-law Philip November, IRS counsel asked a series of questions about Clark Ltd.(as an example) that underscored the enormity of Schulman's fraud upon his investors: why

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[7] The Felcyn Account is Ex. 88-CJ, X-35, see Schedule 4 and pp. 21-28; see also testimony of Felcyn, called as IRS witness, Tr. pp. 244-252, X-36.

would Clark Ltd. part with all of its $165,000 cash and pay an additional mortgage price of $565,000 (total of $730,000), to acquire a Post Office which it could have bought for $74,000 cash plus $241,000 of mortgages (total of $315,000)? Obvious answer: if managed by an honest general partner, it would not do so. Although the Tax Court had recited all of those numbers, it did not comment on this questioning.[8]

8. What was happening up front and behind the scene in 1984-'88. Schulman named and paid his own tax counsel, Bruce Hochman and Martin Gelfand of Hochman Salkin & De Roy, to file petitions for and represent his investors in Tax Court. They filed Tax Court petitions for some

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[8] This questioning of November appears at Tr. pp. 294-306, X-34. The numbers involved, and description of Schulman's control of purchases and resales, are recited by the Tax Court at Op. pp. 3-5, 9-11, 14.

3000 investors; in early 1985 they filed one for James and Vera Marine.

On March 24, 1986, said counsel circularized their Schulman investor-clients with a Memorandum (Ex.110, X-24) which: described an IRS settlement offer to allow all later year Schulman partnership deductions and waive all penalties in return for disallowance of the first year cash loss deductions; recommended against acceptance because they had a good case and because the IRS 1983 agreement was much better; described their conflict of interest in also representing Schulman in the tax fraud case against him; stated that investors were free to choose their own counsel, which few if any did because that would have required paying their own counsel fees.

In a circular Memorandum of April 27, 1987 (Ex. 111, X-25) said counsel reversed themselves, recommended acceptance of the IRS offer, citing the unfavorable trend of Tax Court decisions. Neither the 1986 nor the 1987 memo described any significant difference of tax interest between Schulman and his investors. Neither contained the slightest hint of Schulman fraud upon his investors.

Shortly after receiving the 1987 Memo the Marines retained Arthur Armstrong as their Tax Court counsel[9]; they didn't

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[9] Arthur A. Armstrong, admitted to the bar of this Court in 1941, is a senior tax attorney who began his tax career in 1938 in the Tax Division, Department of Justice, where his experience included writing a monograph on Bureau of Internal Revenue procedure for the Attorney General's Committee on Administrative Procedure. Mr. Armstrong has also represented 23 co-litigants who have stipulated in Tax Court to bind their Schulman partnership issues to the outcome of this Marine case. This has been and is a largely pro bono effort for Mr. Armstrong; fees collected from all clients have been insufficient to cover his office overhead. At age 84 and generally

believe that the IRS offer was fair, but didn't have the funds to accept it in any case.

However Hochman and Gelfand began to stipulate with IRS counsel for settlements-per-IRS-offer by the thousands, were continuing to do so at the July 1988 call of the trial calender for the Marine case; this despite the fact that earlier in 1988 our Tax Court Judge Cohen had permitted them to withdraw as trial counsel for those of their investor-clients who didn't choose to settle. Some 23 of these latter retained Armstrong and bound themselves to the outcome of the Marine case.

It has been a common IRS procedure in tax shelter cases to offer to settle by

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retired, Mr. Armstrong has withdrawn as Tax Court counsel for co-litigants. He will withdraw as counsel of record in this case after the filing of this petition. Arrangements have been made for substitute counsel to take over this Marine case if certiorari is granted.

allowing deduction for cash loss only, and waiving penalties. Conversely if there is no settlement, all deductions are disallowed and penalties are imposed. This powerful IRS settlement lever is hard to resist in view of the expense of litigation and difficulty of organizing a litigating group.

This harsh procedure is not justified in a case like the present where IRS had to know that investors defrauded by Schulman were represented in Tax Court by Schulman's personal tax counsel acting in conflict of interest. Also, the offer here was twisted so as to disallow deduction for cash loss, allow later year deductions based upon non-recourse debt.

9. Schulman's fraud was directed essentially against his investors. From the record made at the trial of this case it has become obvious that Schulman devised his enormous fraud to personally

profit at the expense of his partnerships and investors. He used all of their cash in his concealed business of buying properties and reselling them to his partnerships at a large price mark-up. His embezzlement of the cash obviously had to be hidden from his investors, which explains his elaborate off-shore money movements to simulate partnership short term borrowings and interest payments. If he hadn't been in the process of embezzling their cash, had merely wanted a tax deduction for his investors, simpler and more honest ways could have been devised.

10. In treating Schulman investors like knowing participants in abusive tax shelters, IRS abused its power; in supporting IRS the Courts below have departed from the accepted and usual course of judicial proceedings. When, in 1984, IRS withdrew from the 1983 agreement

because it discovered that Schulman had not used investors' cash to pay partnership interest but must have embezzled it, reason and honesty compelled IRS to recognize that the investors were victims of Schulman's fraud, not participants in it.

We submit that: in settling with thousands of Schulman investors, through his in-conflict counsel, by requiring surrender of deductions for cash loss; without any attempt to warn those investors of IRS-discovered facts indicating Schulman embezzlement of their cash; IRS was guilty of abuse of power --- or worse!

We likewise submit that IRS was guilty of abuse of power in this litigated case when it strongly contended that the Marines had suffered no embezzlement loss because they participated in an abusive tax shelter.

We further submit that in supporting the foregoing IRS misconduct, the Courts below have departed from the accepted and usual course of judicial proceedings.

11. The IRS approach to real estate tax shelters; effect of its crusade against abusive tax shelters. Between 1976 and 1986 tax shelters generally were under attack by Congress which provided in IRC § 465 for limitation of deductible losses to the amount at risk (investment plus personal liability). However, during those years Congress specifically excepted real estate ownership from that limitation. IRC § 465(c)(3)(D). In a 1977 article, Philip Wiesner, Asst. Legislative Counsel to the Treasury, explained how Congress had thereby sanctioned real estate tax shelters whereby a partnership could buy real estate with non-recourse debt, depreciation from which would create tax losses usable against ordinary income

from other sources; and although depreciation would reduce basis, in that era ultimate sale gain would be long term capital gain.[10]

In its Opinion at pp. 49-50 Tax Court Judge Cohen supporting IRS, brushes aside this important Congressionally-sanctioned real estate tax shelter.

In a Tax Note in the December 1982 issue of the American Bar Association Journal, Commissioner of Internal Revenue Roscoe Egger warned that abusive tax shelters can be hazardous to your wealth,

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[10] In 1976 IRC § 465 placed the amount at risk limitation on certain activities that did not include realty ownership. Joint Committee Explanation, 1976-3 Cum.Bull. pp.45, et seq. The Revenue Act of 1978 (P.L.95-600, § 201(a), generally expanded § 465 to cover all investments, but excluded "the holding of real property (other than mineral property)". See House Report No. 95-1455, 1978-3 Cum.Bull. pp.241, et seq. The real estate exclusion was not removed until the Tax Reform Act of 1986, P.L.99-514, § 503(a). The Wiesner article entitled Tax Shelters -- A Survey of the Impact of the Tax Reform Act of 1976, appeared at 33 Tax Law Review 5 (Fall, 1977).

describing an abusive tax shelter as one "where the claimed tax benefits are disproportionate to the economic benefits". He referred to no statutory exceptions, such as for real estate, and suggested no grandfather protection.[11] That was the beginning of the great IRS anti-tax-shelter crusade.

The hoards of tax shelter cases targeted by that crusade have been mostly non-real-estate cases. Indeed, some earlier Tax Court opinions, including one by our Tax Court Judge Cohen, have noted the real estate exception.[12]

It is common knowledge that the great anti-tax-shelter crusade created an enormous load of cases both at the IRS

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[11] See American Bar Association Journal, December 1982, p. 1674.

[12] See: Estate of Sydney S. Baron v. Commissioner, 83 TC 542, 552 (1984); Charles Siegel v. Commissioner, 78 TC 659, 690 (1982); James L. Rose v. Commissioner, 88 TC 386, fn. 5, opinion by Judge Cohen (1987).

administrative level and for the Tax Court; also that the hundreds of tax shelter decisions of the Tax Court, especially the more recent ones, have been virtually 100% in favor of IRS, causing wonder that so many taxpayers' counsel could be so wrong.

It is, we submit, reasonable to conclude that both IRS and Tax Court, wearying of this burden, have swept into the abusive tax shelter bin every case that seemed to have a tax shelter flavor, without any serious attempt to analyze the statutes applicable at time of investment. We believe that trend is at the root of the mistakes here in tainting investors with the fraud upon them, rather than attending to tax law applicable when they invested, designed to help them as victims.

It is significant that IRS saw no abusive tax shelter problem with Schulman

partnerships in arriving at the 1983 settlement agreement.

12. To what deductions are the Marines properly entitled as Schulman partnership investors in 1979 through 1982? As fully revealed at the Tax Court trial, the situation of the Marines in 1979-'82, the years at issue, was: general partner Schulman expropriated their $96,000 of contributed cash in 1979-'80 while falsely pretending to spend it for partnership interest; each of their partnerships acquired a US-leased Post Office for mortgage debt that represented a large concealed profit for the general partner; nevertheless, each was collecting rent that cared for the property and paid mortgage debt service. In short, their cash was stolen, but their partnerships owned income-producing real estate that was debt-acquired in manner sanctioned by

Congress in exempting real estate from statutory at risk loss limitations.

12(a). The Marines are properly entitled to the theft loss deductions taken in 1979-'80. The record clearly reflects 1979 and 1980 embezzlement, as defined by applicable California law, of the Marines' cash contributions to the Clark and Trout partnerships.[13]

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[13] To support a theft loss deduction it is necessary to establish that a theft or embezzlement occurred as defined in controlling state law. Reg. 1.165-8(d), as applicable in the years in question; Rev.Rul. 72-112, 72-1 CB 60 and cases there cited. A criminal conviction is unnecessary, Willard R. Williams v. Commissioner, 49 TCM 1324, 1334 (1985) and cases there cited. The Tax Court recognized that California law was controlling here (Op. pp. 6, 29-30). Schulman's taking of the contributed cash was criminal theft and embezzlement under California Penal Code §§ 484(a), 506. See People v. Sobiek, 30 Cal.App.3d 458, 463-459 (1973); People v. Pedersen, 85 Cal.App.3d 987, 992-993 (1978); People v. Pierce, 110 Cal.App.2d 598, 609-610 (1952); People v.Mellor, 161 Cal.App.3d 32, 38, 207 (1984); People v. Parker, 235 Cal.App.2d 100, 108-110 (1965). The Tax Court really does not dispute the foregoing; rather, cites cases supporting it. Op. p.29.

At Op. pp. 31-32 the Tax Court rejects the Marines' claim to theft loss for the ridiculous reason, lifted from the IRS brief, that they had received "exactly what they bargained for--title to a post office building with no down payment and claims to tax deductions greatly exceeding their cash investment." Obviously they didn't bargain for Schulman's fraud of expropriating their cash for use in his concealed operation of buying properties and reselling them to his partnerships at large personal profit; they wouldn't have invested a nickel had they known of that fraud.

Furthermore the deductions claimed are for: exactly the amount of their stolen cash; plus real estate depreciation loss deductions sanctioned by Congress.

The Ninth Circuit declined to adopt the foregoing strange theory. Instead, it concluded that theft loss deduction: could

not be taken in the year when the loss was sustained and discovered; had to be postponed until the Marines discovered that theft was the cause.

The statutes applicable in the years in question are set forth in Appendix B, Part 1. They state: deductions are allowed for losses sustained during the taxable year (IRC § 165(a)); provided, for an individual, that they are incurred in business or arise from casualty or theft (§ 165(c)). Section 165(e) states:

> "For purposes of subsection (a), any loss arising from theft shall be treated as sustained during the taxable year in which the taxpayer discovers such loss."

As quoted in Appendix B, Part 1, the Committee Report explains that subsection (e): was a relief measure to protect the theft loss deduction for taxpayers who might not discover their "loss" until

after the statute of limitations had run for the year in which the "loss" was incurred; and permits deduction "in the year in which the taxpayer discovers the loss, and only in that year".

The Regulations in said Appendix likewise speak of discovery of the "loss" and Courts have noted that subsection (e) "refers to the year of discovery of the loss, not of the theft".[14]

The Ninth Circuit here, affirming the Tax Court (Op. pp. 27-28), summarily holds that theft loss is not deductible until knowledge of theft and loss co-exist. The statute does not say that and was not intended to mean that.

The statute refers to a single event----"discovery" of the loss. In the present case the loss was discovered in the year

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[14] Rainbow Inn Inc. v. Commissioner, 433 F.2d 640, 642 (CA 3, 1970); Ramsey Scarlett & Co. v. Commissioner, 61 TC 795, 808 (1974), aff'd 521 F2d 786 (CA 4, 1975).

sustained---1979 or 1980. What the Courts below are really saying is that deduction must be postponed until the "theft" cause is also discovered, which would make deduction depend on two different discoveries. This would distort both the language and the purpose of the statute.

The cash loss here was one "arising from theft" and as such was deductible in the year of discovery of "such loss". In the original year of each partnership, general partner Schulman knew that the cash loss had been sustained, knew that he himself had embezzled the cash, advised his investors to deduct the loss for a false reason. Schulman's lie did not alter the fact the "loss" did, indeed, arise from theft and was, indeed, discovered by both partnership and limited-partner-investors in the year sustained.

The statutory rewrite proposed by the Courts below would postpone deduction

from the year loss is sustained, when deduction is needed, until some uncertain later year. A business loss known and sustained in year A could not be deducted then, even though, as in the present case, while year A is still open and before the Courts, the real cause of the loss is discovered to have been a manager's embezzlement. That interpretation would defeat the Congressional purpose to help theft loss victims.

Reasonable prospects of recovery in the year loss was sustained might defer deduction (see cases cited at ftn. 14, above). Obviously there were none here until many years later when civil suits were started against Schulman, et al.[15] Therefore any recovery income is taxable

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[15] See Tax Court's description of civil suits, Op. pp. 19-23. In 1989 investors received net cash settlements of about 14 cents for each dollar of original cash investment.

when the recovery occurs. Reg. § 1.165-1(d)(2)(iii).

12(a)(1). Conflict of Ninth Circuit's decision below with its decision in Rod Warren Ink. On August 20, 1990, the Ninth Circuit Court of Appeals decided Rod Warren Ink, a corporation v. Commissioner 912 F2d 325, 90-2 USTC Sec. 50,465 in manner conflicting with its decision in this case. That decision, which reversed Judge Cohen's Tax Court decision at 92 TC 995, was cited to the Ninth Circuit, by letter according to that Court's rules, prior to oral argument of this case on December 6, 1990, but was ignored.

There, as here, a dishonest manager had stolen cash and concealed his theft from the equity owner for several years; he failed to file corporate tax returns. Applying IRC Sec. 165(e) strictly, Judge Cohen held that the theft loss could not be deducted until the later year when

discovered, which meant that the corporation had received personal holding company income in the earlier years without any theft loss reduction.

Stressing the Congressional intent to help theft loss victims by enacting Sec. 165(e), the Ninth Circuit reversed, held that that section and the personal holding company provisions should be interpreted to allow the theft loss deductions in the years when the manager stole and concealed his theft.

The present case is a fortiorari for the taxpayers. A holding for them here requires no straining of statutory language; here each cash "loss" was discovered and deducted in the year of theft, warranting deduction in that year as the statutory words prescribe; allowance of deduction in that year will greatly assist the theft victims, who would otherwise have to seek deduction in

some uncertain later year and face a loss year deficiency greatly increased by interest (as well as penalties).

The unjust consequence of the Ninth Circuit's decision postponing theft loss deductions, would be to leave the Marines with tax deficiencies for 1979 and 1980 of about $46,000 which, when increased by penalties and interest (non-deductible), would now be $174,000, 3.8 times larger.[16] Their cash of $96,000, which disappeared in 1979 and 1980, was used by Schulman in those years to create taxable income for himself and others, and revenue for IRS in those years. Cf. Irving Cooper v. Commissioner CCH Dec. 47,257(M) (1991), and cases there cited.

The decisions below have financially devastated the Marines because of interest

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[16] Their original total tax saving for 1979-1982 was $70,700; time and penalties have increased the deficiencies to $271,000.

and penalty interest accruing during the years while this case has pended; yet IRS has known and concealed the facts of Schulman's embezzlement since about 1984.

12(b). The Marines are properly entitled to deductions for partnership losses from depreciation and interest in ongoing partnership years. For almost 3,000 investors the ownership by 600 Schulman partnerships of leased public buildings had economic substance; those who settled with IRS are allowed their partnership loss deductions arising from depreciation and interest based on Schulman-created mortgage debt. The Ninth Circuit concluded, however, that for the Marines, as part-owners of two of those partnerships, there was no economic substance. Which is illogical; and which contradicts what the Ninth Circuit itself said in its Schulman criminal opinion, 817 F2d 1355 at 1357:

> "There is no dispute that the limited partners made capital contributions, or that the partnerships did purchase and did own real buildings in the United States, or that some of the partnership transactions had economic substance apart from their tax consequences."

The record in this case reveals that Clark Ltd. and Trout Ltd., in which the Marines invested, continued to collect rent and pay debt service on their Post Offices through 1986. The record in the civil suits referred to by the Tax Court reflects a 1989 settlement between investors, and Schulman and his finance companies, whereby hundreds of properties (including Clark and Trout Post Offices) were put into a single partnership for the

benefit of the finance companies and investors.[17]

What the record in this case has revealed is: not that there is no economic substance to the ownership of the Post Offices; rather, that Schulman charged his partnerships too high a price for them. Three things about that price: it was deemed realistic for several thousand settling investors; it was not so high as to lead to mortgage default in years under view; payments on the mortgages over the years had economic and tax significance for the recipients thereof.

The Tax Court's Opinion is largely devoted to its thesis that the Schulman partnerships were abusive tax shelters for tax motivated investors. It ignores that theft loss is deductible regardless of tax

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[17] See U.S. District Judge's May 23, 1989 Notice of Settlement in combined proceeding MDL #753-AAH, U.S. District Court for the Central District of California; X-38.

motivation; and that when the Marines invested in real estate partnerships such were a tax shelter expressly sanctioned by Congress. In any event, it proceeds to recite and rely on a mass of facts developed by Schulman in the course of his fraudulent scheme, facts wholly unknown to the Marines when, in 1979 and 1980, they invested in Post-Office-owning partnerships. It tries to justify this approach by attributing fraudulent-Schulman's motives to his partnerships (Op. pp. 46-47); even though it refuses to attribute Schulman's knowledge of his own theft to the partnerships for the purpose of allowing theft loss deduction in the year when the loss was sustained and discovered (Op. pp. 28-31).

In discussing profit motive the Tax Court (Op. p. 46) applies the test of Regulations under IRC § 183 requiring only an "objective" of making "a profit, i.e.,

taxable income"; but then concludes that "profit, i.e., taxable income" was impossible when the simplest of calculations show that it was inevitable here upon any disposition of the property or mortgage debt because of basis reduction caused by depreciation.[18]

(12(b)(1). Conflict of decisions below with this Court's decision in Tufts and the Third Circuit's decision in Pleasant Summit. At Op. pp. 34, et seq., The Tax Court argues its thesis that because the non-recourse mortgage debt on

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[18] The Tax Court (Op. pp. 41-43) stresses lessee purchase options, of which the Marines were unaware, as preventing ultimate profit, but makes the most unfavorable (to the Marines) assumptions about them. In any event, a taxable profit was bound to result for the Marines even if the property was abandoned. James Yarbro v. Commissioner, 737 F.2d 479 (CA 5, 1984). The Tax Court's description of Trout lease rentals (Op. p. 17) is incorrect; Lease Amendments Exs. 65 BM, 66 BN, provide that annual Trout rentals remain at $65,846 or $66,825 throughout the term, would continue to carry the Post Office and its mortgage debt.

each Post Office exceeded its fair market value, as testified to by the IRS expert witness, that debt must be disregarded with disallowance of all deductions for depreciation and interest derived therefrom. Apart from the fact that the Offering Memos did not advise investors that such debt would be non-recourse, that position not only disregarded the Congressional sanction for real estate tax shelters but is in direct conflict with this Court's decision in Commissioner v. John F. Tufts, 461 US 300 (1983). The thoroughly reasoned Tufts Opinion upholds the then IRS position that non-recourse debt is to be treated like recourse debt, at both acquisition and disposition of mortgaged real property, without reference to fair market value. The Tax Court relied on the earlier case of Estate of Franklin v. Commissioner, 544 F.2d 1045 (CA 9, 1976) which, to the extent

inconsistent with Tufts, has been discredited thereby.

We submit that the decision of the Ninth Circuit in this case, that the Marines' Post Office investments lacked economic substance, is essentially in conflict with this Court's Tufts decision and Opinion. The Tax Court's reliance on valuation opinions to disregard the mortgage debt, is clearly in conflict therewith.

Our Tax Court Judge Cohen was reversed by the Third Circuit in Pleasant Summit Land Corp. v. Commissioner , 863 F.2d 263 (1988) which decided, without citing Tufts, that a non-recourse realty debt may not be entirely disregarded, must be upheld to the extent of the property's fair market value. The decisions below are in conflict with the Third Circuit's Pleasant Summit decision.

13. The imposition of penalties in this case shouts the legal distortion and terrible injustice of a system whereby an untenable position can be adopted by IRS and thoughtlessly upheld by Tax and Appellate Courts. The Tax Court (Op. pp. 51-55) imposes the following penalties:

(i) IRC Section 6653(a) adding 5% for negligence or intentional disregard of rules and regulations;

(ii) IRC Section 6661, with respect to 1982, adding 25% to any part of a deficiency attributable to understatement of income tax where the pertinent facts were not disclosed in the return or, in case of a tax shelter (principal purpose of tax avoidance), where there was no authority for the tax return treatment and the taxpayer did not reasonably believe that such treatment was more likely than not proper;

(iii) IRC Section 6621(c), with respect to deficiency interest accruing after 1984, interest to be at 120% of the normal rate, for a deficiency attributable to a tax-motivated (sham or fraudulent) transaction.

Where the evidence before Tax Court Judge Cohen: clearly demonstrated that the Marine thought they were making safe and sound long term investments in Post Offices leased to the U.S. Government; were totally unaware of Schulman's fraud upon them in personally buying and reselling to the partnerships at marked up prices; and were totally unaware of Schulman's not paying interest with their cash contributions, almost certainly indicating his embezzlement; one would suppose that the process of imposing those penalties would raise serious doubts in the Judge's mind about the correctness

of denying all of the victims' deductions.[19]

One also wonders how the Ninth Circuit could deny the theft deductions because of its tortured reasoning that they were claimed in the wrong year, and still allow those penalties to apply to deductions taken in the year when the theft loss was sustained and discovered, even though Schulman had concealed his embezzlement by falsely claiming an interest deduction. Again, there is strong indication from the penalty imposition that the Court paid insufficient attention to correct treatment of the deduction issue.

If all deduction disallowances were to be sustained ---- which we believe to be unthinkable ---- we do not see how: Post

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[19] It should be mentioned that after Schulman was convicted of tax fraud the Tax Court permitted IRS, by amended answer, to increase penalties asserted, and subsequently upheld, against the Marines.

Office investors like the Marines, who in good faith took deductions for actual loses of their cash, and for ongoing depreciation and interest (allowed to settling partners) based on prices the fairness of which they had no reason to doubt; could be deemed negligent or unreasonable or participants in frauds or shams as required by the penalty statutes.[20]

Conclusion. IRS has persisted in misconstruing as an abusive tax shelter plan, the Marines' good faith investments in partnerships owning US-leased Post Offices; and in doing so has punished them as though they were parties to Schulman's fraud upon them. In this process, IRS concealed from the Marines its own

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[20] Cash distributions paid by Schulman (Tax Court Op. pp. 13, 17) no doubt contributed to the Marines' confidence in his partnership K-1 forms which they relied on in preparing their tax returns.

knowledge of that fraud until forced to open its files for the trial of this case. It has complicated and may have prejudiced the outcome of this case by arranging thousands of settlements for other investors with in-conflict counsel paid by Schulman.

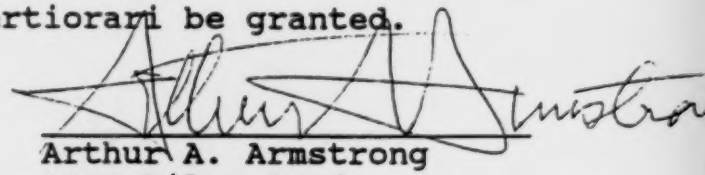
The decisions below are in conflict with decisions of this Court and Circuit Courts of Appeal. Most important of all, they threaten honest taxpayers with financial ruin in a horror of injustice that has so far departed from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision.

Hopefully there are not many cases like this one, where IRS has over-reached its statutory authority and pressured taxpayers into settling cases, or courts into deciding them, in manner amounting to retro-active administrative and judicial

legislation. We submit, however, that this case should furnish the example enabling this Court to draw the line against such abusive practices.

We earnestly pray that this petition for a writ of certiorari be granted.

Dated: 5/20/91



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CERTIFICATE OF SERVICE

I, ARTHUR A. ARMSTRONG, hereby certify that I have on May 20, 1991, by United States Mail, postage prepaid, served copies of the foregoing Petition for Writ of Certiorari, and Appendix thereto, upon all parties required to be served, addressed to each of the following:

Three copies to:

Kenneth W. Starr
Solicitor General
Department of Justice
Washington, D. C. 20530

Two copies to the attorneys for the Commissioner of Internal Revenue Service, Tax Division, Department of Justice, as follows:

Shirley D. Peterson
Assistant Attorney General
Gary R. Allen
Chief, Appellate Section
David English Carmack
Joan I. Oppenheimer
Attorneys, Tax Division
Department of Justice
P. O. Box 502
Washington, D.C. 20044

DATED: May 20, 1991.

Arthur A. Armstrong

Arthur A. Armstrong

CERTIFICATE OF SERVICE OF REARRANGED DOCUMENTS

This certificate is concerned with the foregoing Petition for Writ of Certiorari and Appendix thereto which, in accordance with the Clerk's letter of June 3, 1991 to the undersigned, have had their pages and binding rearranged from like documents originally filed herein. The only substantive changes from the original documents are:

(i) In the Petition, words "along with Ninth Circuit Order denying a petition for rehearing." have been added at end of second paragraph of section headed REPORTS OF DECISIONS AND OPINIONS HERETOFORE RENDERED IN THIS CASE.

(ii) In the Appendix, TABLE OF CONTENTS has been amended by adding the following opposite "Appendix A": "Order of the Ninth Circuit Court of Appeals Denying Petition for Rehearing", with reference to Page 0; immediately following which TABLE, a copy of said Order has been inserted.

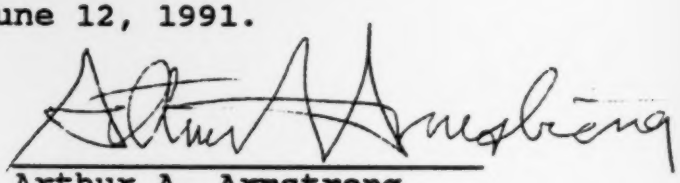
I, ARTHUR A. ARMSTRONG, hereby certify that I have, on June 12, 1991, by United States Mail, postage prepaid, served copies of the foregoing REARRANGED DOCUMENTS upon all parties required to be served, addressed to each of them as follows:

Three copies upon Hon. Kenneth W. Starr, Solicitor General, Dept. of Justice, Washington, D.C. 20530

Two copies upon the following group of attorneys: Shirley D. Peterson, Asst.

Attorney General; Gary R. Allen, Chief Appellate Section; David English Carmack and Joan I. Oppenheimer, attorneys; all of the Dept. of Justice Tax Division, P. O. Box 502, Washington D.C 20044

DATED: June 12, 1991.



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